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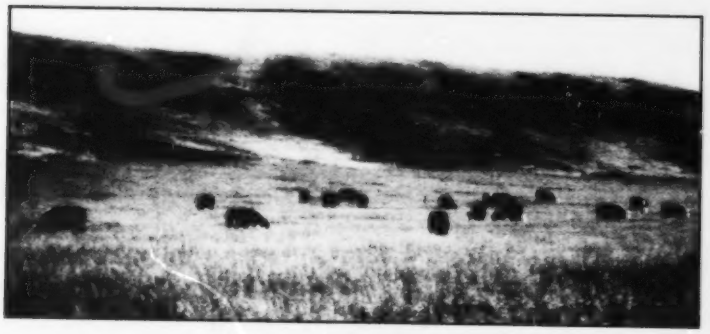

Land Rental

Arrangements

Foreword

This publication outlines the management, legal, and tax considerations of leasing privately owned land. In addition, it provides guidelines for the landlord and tenant when negotiating a rental agreement.

The landlord and tenant should study the material carefully and prepare a written agreement that suits their individual situation. With longer term agreements both parties should remember that economic conditions are uncertain. For this reason, agreements in excess of three years should provide for a periodic review of the essential terms.

Lease forms published by Saskatchewan Agriculture and Food are available from Extension Agrologists and Regional Farm Management Agrologists. These forms are available for Crop Share Leases, Cash Leases and Flexible Cash Leases.

Warning: Landowners who rent land to anyone other than a spouse or child may not qualify for the capital gain rollover, under the Income Tax Act, when the land is transferred to a child. Consult a lawyer, accountant or Farm Management Agrologist for specific information.

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Introduction to Land Leasing

The large capital investment required in farms today can make renting farm property a good alternative to ownership. The 1986 census indicates that 54% of Saskatchewan farmers lease at least a portion of their farm land. Thirty-eight percent of the total farm land is under lease and bigger farms rent a larger portion of their land base as compared to smaller farms.

There are both advantages and disadvantages to leasing land:

1. Advantages

(i) Obtaining Capital

Capital investment is shared between two individuals in a land rental arrangement. The landlord supplies land, buildings, and perhaps some of the operating expenses. The tenant supplies labor, machinery, and usually the major portion of the operating expenses. In this way an operator can reach a larger size of business. It is also a means for becoming established in farming. Since leasing is an alternative to ownership, it is really a means of "financing" a land base.

(ii) Increasing Efficiency

When funds are limited it is often more profitable to spend this money on seed, fertilizer, chemicals, and machinery. Investing scarce funds in land may severely restrict the money available for operating capital thus lowering the efficiency of the farm business.

(iii) Obtaining Farm Experience

Renting enables the beginning farmer to gain needed experience in the financial operation of a farm business before he commits himself to a long-term investment in land. It also enables the operator to learn more about land in an area and leaves him in a more flexible position to change farms or to leave farming. Renting may enable a younger man to obtain the managerial assistance of an older experienced landlord.

(iv) Sharing Risk

By renting, both the landlord and the tenant can share in the risks and uncertainties of farming. This is particularly important to a farmer with limited capital. The extent of the risk-sharing depends upon the nature of the lease agreement.

(v) Father-Son Arrangements

A father-son business arrangement might include a lease agreement whereby the son rents land from the father or rents land from a third party and shares the machinery investment with the father.

(vi) Providing Retirement Income

A retiring farmer might consider leasing all or a portion of his land base rather than selling. The ownership of land provides a hedge against inflation since land values tend to increase with inflation and rising grain prices. The income from the rent provides a form of "pension" income to live on during retirement.

A farmer approaching retirement could gradually phase out of farming by renting a portion of his land and farming the rest of it. In this way, his workload is reduced but he still maintains an interest in farming.

2. Disadvantages

(i) Lack of Security of Tenure

Short term leases create additional uncertainty and insecurity for the tenant. Machinery size and complement must be matched to the land base. The cancellation of a lease could leave the tenant farmer in a high cost situation.

Short term leases provide more flexibility for landlords since it is possible to change tenants quickly or to sell the land. However, short term leases can work to the detriment of the landlord since it will not encourage superior farming practices by the tenant.

(ii) Lack of Efficiency, Conservation and Incentive to Make Improvements

Short term leases may discourage production efficiency. For example, some tenants will not use the optimum amount of fertilizer under a crop share lease unless the landlord shares in the expense of fertilizer.

Most soil conservation practices are of a long run nature. Most tenants with a short term lease are therefore interested only in practices which will show results during the term of the lease. Similarly, improvements of an intermediate or long-run nature (e.g., drainage channel, tree planting, buildings) are not encouraged unless there are provisions for compensation in the agreement.

(iii) Lack of Credit

The tenant farmer usually has a more difficult time to obtain long term credit than does the owner-operator. The three major reasons for this are: the lender requires land as security for the loan; leas-ed land does not build equity; and the lease is short term. The tenant should have no greater difficulty than the owner-operator in obtaining operating and intermediate term credit.

(iv) Lack of Bargaining Power and Managerial Control

There may be situations where the landlord has greater bargaining power even though the tenant is a capable manager. The landlord may insist on making most of the management decisions even though his contributions to the lease may be only one-half of the tenant's. For example, the landlord may insist on certain crops being grown which are not the most profitable as far as the tenant is concerned.

(v) Lost Opportunity for Capital Gain

Land prices have generally increased over time although they do decline occasionally. Land appreciation is an added benefit to the landowner even though the capital gain is not realized until the property is sold.

(vi) People Problems

As with any business venture involving two or more persons, disputes and disagreements can arise.

(vii) Potential Loss of Capital Gain Rollover

Land leased to anyone other than a spouse or child or to a spouse's or child's family farm corporation or partnership means that a taxpayer does not qualify for the capital gain rollover when the land is transferred to a child. However, the individual may be eligible to use the $500,000 Capital Gains Exemption if the land meets the "qualified farm property" criteria or the $100,000 Capital Gain Exemption for other property.

Most of the disadvantages outlined above can be reduced or eliminated by meeting the basic general requirements of any lease arrangement.

II. Requirements for a Successful Lease

1. Compatibility and Honesty

The most important aspect of any lease arrangement is that the landlord and tenant are able to get along together and resolve quickly any disagreements that may arise. Even under the most compatible situations between a landlord and tenant, there are times when they may not be able to agree. Provisions should be made in the written lease agreement for arbitration of differences by a third party whenever the occasion demands a settlement.

It is also important that the individuals are honest. The landlord in a crop share leasing arrangement should be particularly concerned about the integrity of the tenant since he depends on the tenant to give him the specified share of crop.

2. Equitable Terms

Most tenants and landlords want to receive a reasonable return from the lease. If one party feels that his return is unsatisfactory, then it jeopardizes the chance of the lease continuing or in obtaining maximum profits.

3. Written Agreement

A written agreement is preferable so that each party knows what is expected. This will not only prevent misunderstanding but it will encourage both the tenant and landlord to "think through" an equitable and reasonable lease. Each party knows from the written lease what their rights and responsibilities are.

4. Flexibility

In entering into a lease agreement it should be recognized that interests, ambitions and requirements of people change over time. Economic and social conditions also change. Enough flexibility should be included in the written agreement to permit an equitable adjustment to unexpected situations that may appear.

5. Suitability

The arrangement must fit the needs of the individual situation. The lease should be of sufficient duration to permit relatively long-run production practices on the farm. A longer term lease will give the tenant more security and encourage him to use good management practices. The lease arrangement should also be simple enough so that it is workable.

III. Types of Land Leasing Arrangements

The three common land leasing arrangements on crop land are the Crop Share, the Cash Rent and the Flexible Cash Rent.

In all three types the landlord provides the land and usually supplies grain storage and pays the property taxes. The tenant pays the operating expenses, and supplies labor and machinery to farm the land.

The division of income varies with the type of leasing arrangement. In the case of the Crop Share the most common division is a one-third share of all crop sales to the landlord and two-thirds share to the tenant. The income is divided as the grain is sold.

For Cash Rental arrangements the tenant receives the income from all crop sales but pays the landlord a fixed dollar amount each year as the rent. Normally the rent is paid in advance.

In the case of the Flexible Cash Rent, the tenant receives all the income from crop sales but the dollar amount paid to the landlord each year varies with either the price of grain or yield of grain, or both price and yield. The Flexible Cash Rent incorporates features of both the Crop Share and Cash Rent leases.

The amount of risk that is borne by the tenant and landlord depends on the type of leasing arrangement. Two types of risk that occur in land leasing arrangements are:

1) Marketing Risk
2) Production Risk

With marketing risk income is affected by price variations, crops grown, delivery opportunities and storage costs and losses. In the case of production risk, income is affected by the crop yields due to weather, insects, disease, use of inputs and general management.

The following table shows the type of risk borne by the landlord for different leasing arrangements.

Landlord's Risk for Leasing Arrangements

Type of Lease	Marketing Risk	Production Risk
Crop Share Lease	Yes	Yes
Flexible Cash Lease	Yes	No
Cash Lease	No	No

Since the return on an investment should relate to the amount of risk assumed, in the long run one should expect that a landlord would receive a higher total rent from Crop Share Leases, lower rent on a Cash Rental and medium rent for a Flexible Cash Lease.

IV. Rental Rates

Rental rates are largely established by market forces, that is, the supply of and demand for rental land in a district. Landlords and tenants through a process of negotiation and bargaining establish rental rates and conditions of a lease. Tradition has an influence on rents, particularly for crop share leases.

A significant amount of land is rented within families. True market forces may not always apply in these situations.

Prior to entering into a lease, both parties should carefully prepare financial projections. The financial projections should estimate the amount of dollar returns that can be expected.

Often tenants must pay the going rental rate in an area (market rate) or not obtain a lease. The tenant should make financial projections to determine if the income from the leased land will adequately cover the costs and return a reasonable amount for his labour and machinery inputs.

Landlord's should calculate how much return can be expected on their land investment.

For family situations, the tenant and landlord should sit down together and calculate their respective returns to determine if the arrangement is fair.

Types of financial planning techniques that are useful to determine rental rates are as follows:

1. Contributions Approach

The contributions approach is a budgeting method that can be used to test the fairness of a lease arrangement. This approach simply means that "Each party to an arrangement should share the income from the land in the same proportion as they contribute to the costs."

Other things being equal, a tenant should receive a larger share if he contributes more in the way of crop inputs, machinery, labour or accepts a larger risk. By the same token, a landlord should receive a larger rent for more productive, higher valued land.

2. Income Approach

The party doing the calculations estimates the income and expenses for the given situation. The return above expenses is the net income. A tenant or a landlord can make a judgment if the net in-come is sufficient as a return to his labour and investment.

Tenants can use the income approach to determine how much rent they can afford to pay a landlord.

3. Cost Approach

Landlords can use the cost approach to determine how much cash rental is necessary to result in the desired rate of return on the land investment.

4. Crop Share Equivalent Approach

This approach can be used to establish a cash rental rate. The landlord estimates the amount of rent he would receive based on a normal crop share lease. This amount is then used as the basis for establishing or negotiating a cash rent.

5. Market Approach.

The going rental rate and conditions in the area establishes the rent for the land in question. When the market determines the rental rate, each party should do his own financial projections to deter- mine if the returns will be adequate to make the leasing of the land worthwhile.

The financial planning techniques are discussed in greater detail in the sections on crop share, cash rent and flexible cash lease agreements.

V. Cost Guidelines

Use realistic estimates of costs when doing financial planning for leases. Costs may include depreciation, interest on investment, cash operating expenses and labour and management.

Past accounting records provide excellent guidelines for certain costs. Other sources include published reports on production costs, Extension Agrologists and Regional Farm Management Agrologists.

In using the contributions approach to value the landlord's investment allowance, consideration should be given to the fact that land normally commands two types of earnings. These are:

1. An annual earnings amount (rent).
2. Long term appreciation in value (capital gain).

Land values have increased at an average annual compound rate of 8% in the past 30 years and 1% in the last 10 years. Land values have actually been declining since 1982.

The rental earnings plus the capital gains earnings are the total return on land investment.

The earnings from land is similar to earnings from a stock which includes dividends plus capital gains. In contrast, interest is the only form of earnings from a term deposit or guaranteed investment certificate.

For these reasons a 5% annual interest on investment allowance has been used in the examples in this publication with the balance of the earnings coming from anticipated capital gains.

VI. Crop Share Lease

The crop-share lease is the predominant method of leasing crop land in Saskatchewan. In most crop share leases, the landlord receives one-third share of all crops grown on the leased land. The landlord pays the property taxes and supplies grain storage. The tenant receives two-thirds share of the crop and supplies all the machinery, labor and crop inputs.

With today's agricultural technology there are many variations to the standard crop share lease. Often, the landlord and tenant will share some costs such as fertilizer and chemicals in the same proportion that the crop is shared. Share rents are often different than the traditional one-third share.

Occasionally a landlord may supply machinery with the lease or pay part or all of the seed costs.

There are several advantages and disadvantages to Crop Share Leases. These are:

1. Advantages

(i) The landlord and tenant share the risks associated with grain prices, quotas and yields in the same proportion as the share of crop.

(ii) The rent varies directly with the value of production and is paid as the crop is sold, rather than in advance.

(iii) The landlord may pay part of the crop inputs such as fertilizer and chemicals.

(iv) An inexperienced tenant may be able to utilize the management expertise of a landlord with farming experience.

(v) A landlord will make more money in the long run on a crop share arrangement compared to other arrangements providing that the tenant is a good manager.

2. Disadvantages

(i) The results of a tenant's superior farming are shared with the landlord.

(ii) The landlord may wish to influence decisions on the leased land.

(iii) The landlord will make less money on a crop share arrangement compared to other arrangements if the tenant is a poor manager.

(iv) There is more administration and problems on a crop share arrangement than other rental arrangements. (Production, quotas, cash advances, feed fed to livestock.)

(v) The integrity of the tenant is very important to the landlord.

3. The Amount of Crop Share Rentals

Negotiating ability and agreement are the final determinants of how a crop is divided between a landlord and tenant. Small variations in the costs each party agrees to pay and in the crop share ratio are often less important than honesty, compatibility, the tenant's farming ability and prospects for a long term lease. In relation to the tenant's farming ability a landlord would receive as much rent on a one-third crop share as compared to a 40% crop share if the tenant could increase the value of crop production by 20%.

Financial planning by the landlord and tenant either jointly or independently is important to ensure that the amount of rent is satisfactory. Several budgeting techniques are illustrated below.

(i) Contributions Approach for Share Rentals

The contributions approach utilizes the estimated costs of the tenant and landlord to determine the crop share ratio. The contribution approach can be used by a tenant or landlord independently to determine what would be a reasonable crop share ratio and then use this information as background for negotiating with the other party to establish an agreement.

It could also be used jointly by a landlord and tenant to estimate each party's costs and then use the results to establish the share ratio. This approach is most often used in family leasing situations.

The contributions approach can also be used to estimate what would be a reasonable change in a crop share ratio for changes in costs incurred by each party. It could be used to answer questions such as:

"If the landlord pays one-third of the fertilizer and chemical costs, what would be a reasonable crop share ratio?"

"If the landlord supplies some machinery, what would be a reasonable crop share ratio?"

"If the tenant follows a continuous cropping rotation, what would be a reasonable crop share ratio?"

Example

Assumptions
- -- landlord pays property taxes
- -- landlord supplies grain storage
- -- land valued at $350 per acre
- -- tenant pays all operating costs, supplies, machinery and labour
- -- crop rotation is 500/0 wheat and 50% summerfallow

Landlord's Costs Per Cultivated Acre

Investment Cost		
$350 x 5%	$17.50	
Property Taxes	4.00	
Grain Storage (a) Depreciation = $\frac{\$20 - \$2}{30 \text{ yr.}}$ =	0.60	
(b) Interest $\frac{\$20 + \$2}{2}$ x 10% =	1.10	
(c) Repairs $20 x 1½% =	0.30	
Total Landlord's Costs	$23.50	(a)

Tenant's Costs Per Cultivated Acre

Seed	2.00	
Fertilizer and Chemicals	8.50	
Machinery: Fuel, Oil and Repairs	12.50	
Miscellaneous Costs	5.25	
Total Cash Costs	$28.25	
Fixed Costs Interest on Machinery	8.00	
Depreciation on Machinery	8.00	
Total Fixed Costs	$16.00	
Labour Allowance	14.00	
Total Tenant's Costs	$58.25	(b)
Total Landlord's and Tenant's Cost (a+b)	$81.75	

Landlord's Share of Total Costs
= $\frac{\$23.50}{\$81.75} \times 100\% = 29\%$

Tenant's Share of Total Costs
= $\frac{\$58.25}{\$81.75} \times 100\% = 71\%$

These calculations result in a crop share ratio of 71% for the tenant and 29% for the landlord. The results should be considered as a guideline only. Many of the cost estimates are not precise. It is difficult to determine the value of the landlord's land investment since it will vary with the market value of land and the earnings rate selected. The tenant's fixed costs for machinery and an allowance for his labour and management input are similarly difficult to determine and can vary greatly from situation to situation.

a) Sharing Crop Input Costs

Landlord's may agree to share the cost of fertilizer and chemical costs in the same proportion as the crop share ratio. Landlord's often recognize the in- come increasing effect of such inputs and agree to share the costs as a means of ensuring optimum levels of use and to generate more profit.

The contributions' approach in the previous example can be used to illustrate the calculated crop share where two parties agree to share the fertilizer and chemical costs. The fertilizer and chemical costs of $8.50 per acre can be excluded from the tenant's cost schedule resulting in revised total tenant's costs of $49.75 per acre. The landlord's costs remain the same at $23.50 per acre. The relative cost contributions are now 68% for the tenant and 32% for the landlord.

If a 68:32 crop share ratio was agreed to, then the fertilizer and chemical costs would be shared on the 68:32 ratio.

The change in the relative cost contributions would be much greater for land leases where longer crop rotations are followed because of the much higher fertilizer and chemical input costs.

b) Different Cost Structures

With longer crop rotations, high cost specialty crops, and continuous cropping, crop input costs, machinery investments and labor inputs will be higher for the tenant as compared to shorter crop rotations. **Longer crop rotations should provide a larger share of the crop to the tenant.** See Appendix 3 for an analysis described as "Cropping Decisions for Crop Share Leases."

The following table provides a general guide as to how income should be shared if a land leasing arrangement is to be equitable with different levels of tenant's costs and land values.

Landlord's Percentage Share of Crop*

Land Value	Tenant's Cost ($/cultivated acre)**											
($/cult.acre)	40	45	50	55	60	65	70	75	80	85	90	95	100
$100	22	20	18	17	15	14	14	13	12	11	11	10	10
200	29	26	24	23	21	20	19	18	17	16	15	14	14
300	34	32	30	28	26	24	23	22	21	20	19	18	17
400	39	37	34	32	30	29	27	26	25	23	22	21	21
500	44	41	38	36	34	32	31	29	28	27	26	25	24
600	47	44	42	40	38	36	34	32	31	30	29	27	26
700	51	48	45	43	41	39	37	35	34	33	31	30	29
800	53	51	48	46	43	41	40	38	37	35	34	33	32

*The landlord's investment cost in land has been calculated using 5% interest rate plus taxes and building costs estimated at $6.00 per cultivated acre.

**It is important to use realistic estimates of the tenant's costs. In many instances it may be necessary to recalculate the equitable share ratio using the contributions approach outlined in the preceding example.

c) Rental Arrangements with Machinery

Generally the inclusion of machinery in a land rental arrangement is not recommended, however, it can be justified on a short term basis in some circumstances. For example, the landlord may not be able to find a tenant with sufficient machinery to farm the rental property. Perhaps the landlord decides to rent the property for a year or two but is uncertain if it will be permanent. In these circumstances it may be wise for the landlord to retain the ownership of machinery.

When a farmer ceases farming and rents his land but retains ownership of his machinery. he is not permitted under the Income Tax Act to claim capital cost allowance on the machinery unless it is included in a lease.

Including machinery in a land rental agreement has potential problems. The landlord could lose financially if the tenant abuses the machinery through reckless handling and improper servicing or maintenance. The landlord should assess the tenant's farming practices carefully. The written agreement should specify who is responsible for minor and major repairs. If the tenant is responsible for all repairs, it puts the onus on him to operate and service the equipment properly. This could be a disadvantage to the tenant if the equipment is old and the landlord is reluctant to replace it with newer machines. Major repairs (e.g., motor overhaul, replacement of tires) would likely be the responsibility of the landlord providing the tenant has not been negligent.

The share of crop or cash rental based on the contributions approach could vary considerably as very old machinery is replaced with new machinery. For this reason it may be necessary to recalculate the cost contributions for years when the old machinery and equipment are replaced with new implements.

The following example illustrates how to determine the share of crop using the contributions approach when machinery is included in the agreement. Assume that land is valued at $350.00 per acre, and the tenant pays for all fuel, oil and minor repairs. Fertilizer and chemicals are paid by the tenant.

Landlord's Costs Per Cultivated Acre

Investment Cost	
$350 x 5% =	$17.50
Taxes	4.00
Grain Storage	2.00
Machinery Repairs (major)	4.00
Machinery Investment	8.00
Depreciation	8.00
TOTAL	$43.50

Tenant's Costs Per Cult. Acre	
Seed	$2.00
Fertilizer and Chemicals	8.50
Miscellaneous Costs	5.25
Machinery Fuel, oil, repairs	8.50
Labor	14.00
TOTAL	$38.25

Total Costs Landlord and Tenant = $81.75
Landlord's Share of Total Cost (43.50/81.75) x 100% = 53%
Tenant's Share of Total Costs (38.25/81.75) x 100% = 47%

(ii) Income Approach for Share Rentals

The income approach is used to calculate the profit remaining after the costs have been accounted for. It is really a budgeting method. Each party should calculate his expected profit from a lease arrangement prior to agreement.

(a) Tenant's Position

A tenant can use the income approach to estimate how much profit is available from a lease arrangement. If land becomes available for lease, the tenant can estimate how much rent he can afford to pay. If a landlord offers to rent land to him at a stated share ratio, the tenant can determine if the returns are sufficient to provide a satisfactory return on his machinery investment and for his labour input.

Example

Assumptions:

- Landlord offers to rent 160 acres of land to a tenant for a 40% share of the crop.
- The landlord will pay 40% of the fertilizer and chemical costs.
- Landlord will pay property taxes and supply grain storage.
- Tenant will follow a crop rotation of 50% wheat and 50% summerfallow.
- Tenant and landlord will share government payments on a 60:40 ratio.
- Tenant does not require additional machinery investment.

Tenant's Budget

Income:	
Wheat 80 acres x 35 bu/ac x $3.00/bu x 60% share	$5,040
Government payment $1200 x 60% share	720
Total Income	$5,760
Cash Expenses:	
Seed 80 acres x 1.25 bu/ac x $3.50/bu	$ 350
Fertilizer 80 acres x $5.00/ac. x 60% share	240
Chemicals 80 acres x $12.00/ac x 60% share	576
Machinery Operating Costs (160 acres)	1,800
Crop Insurance	300
Miscellaneous Cost (160 acres)	600
Interest (operating capital)	200
Total Cash Expenses	4,066
Return above cash costs	$1,694

Return above cash costs = $\frac{\$1,694}{160 \text{ ac}}$ = $10.59 per acre

The calculations can serve as a basis for making a decision if the expected returns are sufficient to make the lease arrangement worthwhile. The return above cash costs represents the estimated return for the tenant's labour and machinery input.

In the above example, no additional machinery was required to farm the land. In the short run most farmers can handle a small increase in the farm size with no additional machinery investment. However, it will involve more hours of labour to farm the entire farm operation. Timeliness of operation may be adversely affected. Often a farmer will expand his acreage and cope with his existing line of machinery. When he begins to replace his machinery in the future he will buy larger machinery to accommodate the larger land base. Effectively, the additional land previously taken on does result in added machinery investment but at a later date. This possibility should be considered when renting additional land where there is no immediate change in machinery ownership.

If additional machinery must be purchased the added depreciation and interest on investment should be charged as a cost against the land to be leased. The following example illustrates a budgeting technique to cost out additional machinery investment.

A farmer is going to lease an additional one-half section of land and estimates that he will require $24,000 of additional machinery investment. The estimated extra annual fixed costs are as follows:

$$\text{Depreciation} = \frac{\text{Original Cost - Salvage Value (10\%)}}{\text{Years of Use}}$$

$$= \frac{\$24{,}000 - \$2{,}400}{12 \text{ years}} = \$1{,}800 \text{ per year}$$

Interest on Investment

$$= \frac{\text{Original Costs + Salvage Value}}{2} \times \text{Interest Rate}$$

$$= \frac{\$24{,}000 + \$2{,}400}{2} \times 10\% = \$1{,}320 \text{ per year}$$

Insurance (0.5%) = $24,000 x 0.5% = $ 120 per year

Extra Annual Fixed Costs = $3,240 per year

$$\text{Extra Fixed Costs/Acre} = \frac{\$3{,}240}{320 \text{ ac}} = \$10.12$$

Tenants may enter into a lease where the expected profits are not adequate in the short run but commodity prices are expected to improve and result in adequate profits in the near future. This is an important consideration if the lease is likely to be a long term arrangement or the tenant will have the option to buy the land.

(b) Landlord's Position

Landlord's can use the income approach to calculate the return to land investment. The following example illustrates this approach.

Assumptions:

- Landlord can rent 160 acres for a rent of 40% crop share.
- Landlord will pay 40% of fertilizer and chemical costs.
- Landlord pays property taxes.
- Property is valued at $50,000 including $3,000 for grain storage.
- Tenant will follow a crop rotation of 50% wheat and 50% summerfallow.
- Landlord will receive 40% of government payments.

Landlord's Budget:

Income

Wheat 80 acres x 35 bu/ac x $3.00/ bu x 40% share	$3,360
Government Payment $1200 x 40% share	480
Total Income	$3,840

Cash Expenses

Fertilizer 80 acres x $5.00/acre x 40% share	$160
Chemicals 80 acres x $12.00/acre x 40% share	384
Property Taxes	640
Interest on Operating Capital	60
Total Expenses	$1,244
Return Above Cash Expenses	$2,596
Return on Investment Calculation	
Return Above Cash Expenses	$2,596
Depreciation on Granary $3000 x 5%	150
Return to Property Investment	$2,446

% Return = $2,446/$50,000 x 100% = 4.9%

A landlord can use the calculations to decide if the return is adequate. If it is not he can attempt to obtain a higher share of the crop or negotiate a lease in which the tenant pays all the costs of fertilizer and chemicals. If this is not possible then the sale of land could be considered and the proceeds placed in alternative investments.

Many landlords recognize that farm incomes tend to run in cycles and decide to ride out periods of low returns in anticipation of greater profits and capital appreciation in land values in the future.

A worksheet is provided in Appendix I to assist with crop share rental calculations.

4. Crop Share Lease Agreement

In addition to the points listed for all leases, a crop share lease agreement should include the following:

(i) Cropping Decisions

Normally, the tenant makes the cropping decisions about crops to grow, acreages of each and use of inputs. Occasionally, the tenant may discuss cropping plans with the landlord and in some cases the landlord may want a direct say in the cropping decisions.

(ii) Use of Fertilizer and Chemicals

The tenant and landlord can agree to the amount of crop inputs to apply and as to how such costs will be shared. It is recommended that both parties share the cost of fertilizer and chemicals in the same proportion as the crop is shared. In situations where the tenant pays the entire cost, he has less financial incentive to apply optimum levels of crop inputs as compared to situations where both parties share those costs proportionally.

However, the method of sharing input costs should affect the division of the crop. For example, the tenant's share should be larger when he supplies all input costs as compared to a situation where some input cost are paid by both parties.

(iii) Crop Insurance

The three main types of insurance available for crops are as follows:

(a) Hail insurance is offered by private companies as insurance against hail or fire on a spot loss basis.

A tenant or landlord may insure their share of the growing crop separately by purchasing insurance coverage separately from any company offering hail insurance.

(b) All risk crop insurance is offered by the Saskatchewan Crop Insurance Board which guarantees the value of a minimum level of grain production from all losses (hail, fire, theft, drought, etc.). Spot loss hail insurance is part of the program.

There are two ways that Saskatchewan Crop Insurance can be handled in a crop share lease. These are:
- only the tenant insures under the program. He pays all the premiums required and receives all the indemnities. The landlord has no coverage under these programs.
- the landlord and tenant can jointly share the costs and benefits of crop insurance even though the contract is with the tenant. The parties agree to share the premiums and benefits of crop insurance on the rented land in the same proportion as the share of crop. For example, assume the land farmed by the tenant consists of 100 acres of rented land and 500 acres of owned land. With a Saskatchewan Crop Insurance premium of $600 the premium associated with the rented land is 100 acres/600 acres x $600 =$100. The landlord's share of the premium in a 1/3-2/3 crop share arrangement is 1/3 x $100 =$33.33. Any benefits realized from All Risk Crop Insurance could be shared in the same manner. Except for 'spot losses' associated with hail and fire, claims under the Saskatchewan Crop Insurance Program are based on the total unit which combines the rented land and the operator's land. For this reason it could be difficult to determine the losses and benefits of All Risk Crop Insurance belonging to rented land.

(c) Revenue Insurance

Revenue insurance was introduced in 1991 as part of the new long-term safety net program called G.R.I.P. (Gross Revenue Insurance Plan). Revenue insurance plus crop insurance is G.R.I.P.

Revenue insurance is offered by the Saskatchewan Crop Insurance Corporation which guarantees a price on eligible commodities at 70% of a 15 year indexed moving average price (IMAP). The revenue insurance guarantee for an eligible commodity is determined by multiplying the producers average yield by the 70% I.M.A.P. The total guarantee will be the seeded acres times the guarantee per acre.

Revenue insurance can be handled in a crop share lease as outlined in (iii)b) above for crop insurance or in any other manner that may be negotiated on and agreed to by the landlord and tenant. These may include such options as follows:

1) Traditional Crop-Share Lease With Minimum Cash Guarantee

The tenant could agree to pay the landlord a minimum cash rent based on the guarantees afforded by GRIP. If the landlord's share of crop sales from the leased land was less than the minimum cash rent, the tenant would pay the difference to the landlord. In practice, the landlord could receive his or her share of crop as sales occurred and Canadian Wheat Board payments, if any, are realized. After all the crop is sold, the final prices are realized and the final GRIP indemnities are accounted for, the tenant would make a cash payment to the landlord if the crop share income is less than the minimum cash rent guarantee.

The minimum cash rent should take into account the GRIP guarantee for typical crops and crop rotations that would be followed on the leased land.

2) Grow a Unique Crop on Leased Land

Indemnities and premiums could be identified on leased land separately from the tenant's total farm by growing a unique crop on the leased land. For example, barley might be grown on the leased land and different crops on the other land farmed by the tenant. If a claim occurred on barley, that year, it would not be offset by gains from other crops on other land. The tenant and landlord could share the market proceeds, GRIP indemnities, if any, and GRIP premiums on the same basis as the overall crop sharing arrangement.

3) Landlord Shares Income From Tenants Whole Farm

The landlord would obtain a share of income from the tenant's whole farm rather than from only the leased land. Further, the landlord would pay a proportionate share of all GRIP premiums and receive a proportionate share of all GRIP indemnities from the whole farm.

Reference should be made to a FarmFact produced by Saskatchewan Agriculture and Food and Saskatchewan Rural Development entitled "Land Leasing and Farm Safety Net Programs" for more details.

(iv) Quota Allocation

The Canadian Wheat Board requires that the actual grain producer allocate quota acres. In some instances this could be to the detriment of the landlord since quota acres arising from rented land are not separate from the quota acres farmed by the tenant. For this reason a clause may be included in the written agreement which specifies how quota acres will be allocated.

Most often, the landlord will rely on the judgment and honesty of the tenant to allocate the quota acres to mutual advantage. Where allocation is made by mutual agreement the lease should specify how the acres will be assigned when agreement is not possible. Crop quota acres identified with the rented land should not be less than the rented acreage eligible for quota assignment purposes.

(v) Delivery and Sale of Grain

Indicate who is responsible for the delivery and sale of quota and non-quota grains. Usually the tenant is responsible for the delivery of quota grains in accordance with prevailing quotas and market conditions. The landlord, on the other hand, often wishes to specify how non-quota grains such as canola and flaxseed are to be sold.

VII. Cash Lease

In a cash lease the tenant pays a fixed cash payment to the landlord for the use of the land and improvements. The tenant receives all the income. He supplies labor, machinery and pays all the expenses except for property taxes, building insurance and major building repairs.

A cash lease is especially suited to absentee landlords and other landlords who wish to be assured of stable income without much administration. With widely fluctuating grain prices landlords and tenants may not prefer a cash rent. A flexible cash rent which is tied to grain prices may be more appropriate.

The following are the advantages and disadvantages of cash leases:

1. Advantages

(i) The landlord receives a guaranteed return and does not have to be concerned about crop yields, grain prices, quota restrictions, crop rotations or the tenant's honesty. Because he accepts less risk, the rent is normally lower than on a crop-share basis.

(ii) The tenant has more flexibility and independence in production and management decisions.

(iii) The results of superior production accrue entirely to the tenant.

(iv) The tenant is able to make contributions to the Western Grain Stabilization Plan on all the grain sales as compared to only his share on a crop share lease.

(v) There is less administration.

(vi) Production can be used for livestock feed or seed more easily than on a crop-share lease.

2. Disadvantages

(i) The tenant assumes all production and marketing risk.

(ii) Rent is paid in advance of crop sales. There is a greater requirement for operating capital.

(iii) The landlord does not get the benefit of high prices or unusually good crops.

(iv) Because of the risk of changing circumstances, the leases are normally short term.

(v) The landlord has less influence on a tenant's management.

3. The Amount of Cash Rent

Landlords and tenants either jointly or individually may use budgeting guidelines to calculate cash rents or as background to assist in making a decision about a cash rental offer.

Three methods are indicated to arrive at cash rental rates. These are (i) the cost approach, (ii) the crop share equivalent, and (iii) the income approach.

(i) Cost Approach

With the cost approach, the landlord determines all his costs associated with the ownership and leasing of the land. Costs include property taxes, insurance, depreciation and interest on investment. The cost approach does not consider the tenant's position.

Example

Landlord's land value is $64,000 for a quarter section.

Landlord pays property tax.

Supplies granaries with a value of $2500.

Landlord's Costs:

Property Taxes	$ 500
Granary Depreciation $2500 x 5%	125
Land Investment Cost $64,000 x 5%	3,200
	$3,825

Cost per acre = $\frac{\$3,825}{160 \text{ ac}}$ = $23.91 per acre

The cost approach indicates the level of cash rent required by the landlord to achieve a specific return on his land investment.

(ii) Share Equivalent Approach

The rent normally realized by a landlord from a crop share lease is the basis for the calculation of a cash rental amount.

Example

Landlord has 160 acres to rent. Normal crop share to landlord in the district is one-third share. Normal crop rotation is 50% wheat and 50% summerfallow. Expected wheat price is $3.00/bushel. Expected government payments are $1000 per quarter section.

Calculation Procedure:

Expected Total Income:

Wheat 80 acres x 30 bu/ac x $3.00/bu	$7,200
Government Payments	1,000
Total Income	$8,200
Normal Share of Income, $8,200 x one-third share	$2,733
Income per acre = $\frac{\$2,733}{160 \text{ ac}}$	$17.08

Income per acre (10%discount)	$15.37
Income per acre (20% discount)	$13.66

The income from a normal crop share should be reduced by a factor of 10% to 20% for two reasons. These are:

a) a cash rental is normally paid before the crop is sold while the income from a crop share rental is received as the crop is sold. The interest rate for the difference in the time of the receipt of income should be applied as a reduction to the cash rental.

b) a landlord accepts less risk on a cash rental since the landlord's income on a crop share will vary with grain prices and yields.

(iii) Income Approach

The use of the income approach by tenants and landlords was discussed in the section on crop share leases. The value of this approach is just as important in planning a cash rental. For a tenant, the difference between a cash rental and crop share rental in relation to the income approach is that he would be entitled to all the income from crop production and government payments. Further, there would be no sharing of crop input expenses.

The income approach is a valuable technique to assist a tenant in deciding what level of cash rent to offer to a landlord or to determine if he can afford to pay the cash rent asked by a landlord.

Worksheets in Appendix 1 are provided to assist in planning cash rent and crop share rental amounts.

4. Cash Lease Agreement

In addition to the points listed for all leases, a cash lease should include the following:

(i) Date(s) on which the rental is payable. The payment of the cash rent can be any schedule agreed upon by the landlord and tenant. Examples of two alternatives are:

(a) The rental is payable in full by April 1 for each year of the agreement (or)

(b) The rental is payable (one-half, one-third, etc.) by April 1 and the balance by December 1 for each year of the agreement.

(ii) Special rights of the landlord if the rent is in arrears.

The landlord should be given the right to repossess and occupy the rented land if the tenant fails to make the payments according to the schedule outlined in the agreement. In addition, he may use any other means under the law (e.g., seizure of crop, grain or chattels), to collect the rental. If this becomes necessary legal advice should be obtained before any action is taken.

(iii) Where desired a flexible rent formula and how it will operate should be clearly outlined in the written agreement.

VIII. Flexible Cash Lease

Flexible cash leases are cash rentals with features which allow the actual amount of rent paid to vary with changing conditions; usually changes in prices or production, or both. Flexible cash leases combine some of the features of each of the cash lease and crop share lease.

Flexible cash leases that are adjusted with changing production or yields can be complex to administer, since accurate production records are required. The need for flexibility in cash rent leases is more important when sharp swings in grain prices occur.

It is important to keep the lease and the procedures for calculating the rent simple. Rather than a complex system which involves a cash rent based on production and price changes, it is often better to enter into a crop share lease which offers complete flexibility anyway.

Flexible cash leases in which the rental rate adjusts with the price of grain are more appropriate and simpler to administer.

1. Administration

Flexible rental rates based on grain prices can be administered in two ways. These are:

(i) A quantity of grain of a specific grade is agreed to by the tenant and landlord for each acre of land or quarter section of land to be leased.

The cash rent is determined by multiplying the agreed-to quantity of grain by the price of grain. If the grain is marketed on the open market, the parties could agree beforehand to a date on which the price would be set (e.g. street price on October 15 of each year).

If the grain is marketed by the Canadian Wheat Board, the tenant would pay a cash amount to the landlord each time the Canadian Wheat Board announced an initial, adjustment, interim or final payment for the grade of grain called for in the lease.

The landlord may require the tenant to make an advance payment in the spring before the crop is seeded. This would be applied against the payment in the fall when the initial price is known or the street price can be determined.

(ii) The tenant delivers into an elevator in the landlord's name, an agreed to quantity and grade of grain (e.g. 800 bushels of No. 2C.W. wheat for a quarter section of land). A cash purchase ticket is issued to the landlord and he receives any adjustment, interim and final payments directly from the Canadian Wheat Board.

If a grade other than that agreed to was delivered, then a cash adjustment would be required between the two parties.

The following are the advantages and disadvantages of flexible cash leases:

2. Advantages

(i) The tenant has greater independence in decision making as compared to a crop-shared by the landlord and tenant.

(ii) The risk of changed in grain prices are shared by the landlord and tenant.

(iii) The tenant captures all the benefits of superior management.

(iv) There is less administration as compared to a crop-share lease but more compared to a cash lease.

(v) The landlord's rent is guaranteed in relation to quantity but not the price of grain.

(vi) The tenant can enrol the subject land into a GRIP contract.

3. Disadvantages

(i) The tenant assumes all the risks of crop production.

(ii) The landlord has less influence on the tenant's management.

4. The Amount of Flexible Cash Rent

The quantity and grade of grain in a flexible cash lease should relate to normal crop production on the leased land, normal grades of grain grown and the normal share that a landlord would receive in a crop share lease.

The following example illustrates a procedure to calculate the amount of flexible cash rent.

Example:

1/4 section of land, 150 acres cultivated, Crop Rotation: Wheat--Wheat--Fallow
Yields: Fallow Wheat 33 bushels per acre Stubble Wheat 24 bushels per acre

Normal Crop Share in District: 1/3 share to landlord

Step 1: Calculate Average Wheat Production

50 acres wheat fallow x 33 bu/ac=	1,650 bu.
50 acres wheat stubble x 24 bu/ac=	1,200 bu.
Average Wheat Production=	2,850 bu.

Step 2: Calculate Landlord's Normal Share
2850 bushels x 1/3 share = 950 bushels

Step 3: Reduce landlord's normal share by 5% to 15% to account for the interest on the timing of rent payment and risk as compared to a crop share rental. (Note that this adjustment is suggested as being less than the adjustment for a full cash rental.)

950 bu x 10% discount = 100 bu (approx.) Bushel Rent = 950 bu - 100 bu = 850 bushels.

Step 4: Calculate Rent Based on Grain Price

The following table shows the total rent with varying wheat prices:

Wheat Price ($/bu)	Landlord's Quantity of Wheat (bushels)	Total Rent
2.50	850	$2,125.00
3.00	850	2,550.00
3.50	850	2,975.00
4.00	850	3,400.00
4.50	850	3,825.00
5.00	850	4,250.00
5.50	850	4,675.00

Although the tenant may grow any crop or combination of crops, it is usually preferable to use one commonly grown grain as the base for rent calculation.

Other types of flexible cash lease agreements may account for variations in both grain prices and crop yields. However, these agreements are more complex and often a crop-share lease would be the better type of lease to use.

5. Flexible Cash Lease Agreement

In addition to the points listed for all leases, a flexible cash lease should include the following:

(i) Dates on which rental is payable and the method of calculating the rental.

(ii) The delivery point at which prices are to be determined or to which the landlord's quantity of grain is to be delivered.

(iii) Special rights of the landlord if the rent is in arrears.

The landlord should be given the right to repossess and occupy the rented land if the tenant fails to make the payments according to the schedule outlined in the agreement. In addition, he may use any other means under the law (e.g. seizure of crop, grain or chattels) to collect the rental. If this becomes necessary legal advice should be obtained before any action is taken.

IX. Written Agreements

A satisfactory lease is one which contains adequate provisions for governing the rental arrangement and is agreed to by a landlord and tenant. Lease agreements should include all the important terms and be in a written form. A written lease serves as a reference in case of disputes and assists in reaching a clear understanding. All leases should contain the following:

1. Names and Addresses of Tenant and Landlord

2. Description of Property to be Rented

The agreement must specify the common legal description of the rented land (e.g., NW 16-17-19-W3). Certain areas or permanent buildings to be excluded must be specified. For example, the landlord may wish to exclude the farm house and continue residing on the premises.

3. Length of the Lease

The agreement must state the duration of the lease including the time it commences and terminates. Longer term leases are desirable since they reduce the uncertainty and insecurity experienced by the tenant and encourage him to farm the land properly. Since economic conditions may change, agreements in excess of three years should provide for a periodic review of the essential terms.

4. Amount and Payment of Rent

The rent payable for leased land is usually a share of crop or cash rent. Negotiation and agreement are the final determinants of the amount of rent, although the contributions approach can be used to test the fairness of the rental arrangement. The rent and payment schedule must be stated in the written agreement.

5. Responsibility of Taxes

Unless specified otherwise in the written agreement, taxes are the responsibility of the landlord.

6. Compensation for Repairs to Buildings, Fences, and Improvements

The written agreement should state who is responsible for repairing buildings, fences, and other improvements, and how the expenses will be shared. A common practice is to have the tenant responsible for all minor repairs and for the landlord to reimburse the tenant for improvement costs which have a lasting benefit longer than the rental term.

7. Rights, Responsibilities, and Compensation for Major Improvements

Provisions should be made in the lease to compensate the tenant for major improvements which extend beyond the length of, or termination of, the lease. Major improvements include building and fence construction, erosion control, water development, and clearing and breaking. It is usually required that the tenant obtain written permission from the landlord before making major improvements. It is also important to outline how the value of improvements will be determined and when compensation will be made. A tenant will sometimes do clearing and breaking on leased land. In order to reimburse the tenant for the improvement, the landlord may let the tenant farm the improved land rent free for a number of years.

The number of years of free rent should relate to the fair market value of the improvement made by the tenant, interest rates and the normal rent that would be obtained by the landlord on the improved land.

To determine the number of years of free rent for the tenant the value of the improvement could be considered like a loan. By using amortization tables, after the interest rate and value of rent have been determined, the number of rent free years can be determined. For example, if the value of the land improvement was $100.00 per acre, the interest rate was 10% and the normal rent on the improved land was $20.00/acre, the result would be 7 years. (The amortization factor to pay off $1.00 at 10% over 7 years is .2054, therefore it would take approximately $20.00 to pay off $100.00 in 7 years.)

8. Rights to Assign or Sublet the Lease

The written agreement could contain a clause which prevents the tenant from subletting or assigning the lease to another individual without the written consent of the landlord.

9. Restrictions and Responsibilities Regarding Production Practices and Management Decisions

The written agreement should specify those production and management decisions which the landlord insists be carried out by the tenant.

(i) Summerfallow

The landlord may require the tenant to summerfallow a portion of the cultivated acreage. To encourage the tenant to fulfil this commitment a penalty is often specified which is payable to the landlord when the lease is terminated or renewed. A similar compensation should also be made by the landlord to the tenant when the summerfallow acreage exceeds the required amount. The amount of compensation is a matter of negotiation between the landlord and tenant.

The party to a lease arrangement who incurs a loss created by a change in the usual or required cropping rotation should be reimbursed to the extent of their reduced income.

This approach is outlined in the following example:

Assumptions:

Crop rotation 1/2 crop -- 1/2 summerfallow

Yields

--summerfallow wheat	25 bushels per acre
--stubble wheat	15 bushels per acre
Rental Arrangement	1/3-2/3 crop share

All the land is cropped in the last year of the agreement. The landlord farms the land himself the next year.

Calculations:

Additional Income to Landlord (last year of lease agreement)
Stubble Crop
15 bushels per acre x 1/3 share = +5 bushels
Reduced Income to Landlord (next year)
Summerfallow yield (foregone) 25
Stubble crop yield received 15
-10 bushels
Net loss by landlord = 5 bushels of wheat

Equitable Approach:

Since the landlord has received a lower income because the tenant altered the usual or required cropping rotation he should be reimbursed for this loss. The landlord's loss includes the value of the reduced yield plus the additional costs of stubble cropping compared to summerfallow cropping. In the example, the tenant should pay the landlord the value of 5 bushels of wheat of a specific grade plus the additional costs of stubble cropping over summerfallow cropping such as fertilizer, weed control costs and insurance. In situations where there is a high level of fertilizer applied to the stubble crop, the yield reduction may be reduced thereby reducing the total loss per acre to the landlord. The loss to a landlord receiving a cash rent would be greater than that illustrated above for a crop share rental.

There should be provisions in the agreement whereby the summerfallow requirement can be waived under certain circumstances. For example, with very favourable moisture conditions and a crop-share arrangement the landlord and tenant may feel it is to their mutual advantage to crop the entire cultivated acreage.

(ii) Other Requirements

The following factors should also be considered in drawing up a crop leasing agreement:

--cropping decisions
--use of fertilizer and chemicals
--crop insurance
--quota allocation
--delivery and sale of grain

10. Responsibility for Grain Storage

The written agreement should outline the minimum amount of grain storage, if any, to be provided by the landlord. If additional grain storage is required it is usually provided by the tenant.

11. Grain Stored on Land at Commencement and Termination of Lease

The written agreement should specify how long undelivered grain can be stored on the rented land without storage charges.

12. Right of Entry

The landlord or a representative of the landlord should have the right at all times to inspect the rented property and remove any grain stored on the land which he wasn't able to sell at the commencement of the lease. Similarly, the tenant should be able to remove his share of grain stored on the rented land or complete harvesting of the crop after termination of the lease agreement. The Agricultural Leasehold Act protects the tenant's interests.

An incoming tenant, purchaser or landlord should have the right to enter on the land after harvest in the last year of the agreement to prepare the land for next year's crop.

13. Arbitration

It is considered desirable to include an arbitration clause in the written agreement. Any disagreement which might arise and which cannot be resolved between the landlord and tenant would by mutual agreement be referred to a third party who would act as an arbitrator. This approach is usually preferable to a court case which can be very costly.

14. Option to Buy

The landlord may give the tenant an option to buy the land under lease at some time during the lease or at the end of the lease. Another alternative is a "Right of First Refusal" whereby, should the landlord ever wish to sell the land, then the tenant is given the right to buy the land at the same terms and conditions offered by another purchaser.

15. Compensation for Property Damages

The party who has suffered any loss should receive any compensation payable. For example, if a payment is made as a result of crop damage, the tenant should receive the entire compensation in the case of a Cash Rent, but the compensation should be shared in the same portion as the crop is shared in a Crop Share Rent. In the case of capital damage to land, the landowner should receive the entire compensation.

16. Government Payments and Subsidies

Government payments and other subsidies are normally handled differently for a crop share lease than for a cash lease.

For crop share leases, government payments and subsidies for which no contributions are required and which relate to grain production, grain prices or land area should be shared by the tenant and landlord in the same proportion as the crop share ratio. When contributions are required to qualify for a government payment or subsidy, the entitlement should be shared in the same proportion as the landlord and tenant pay the contributions. If the tenant pays all contributions, then he should receive all entitlements.

For cash leases and flexible cash leases it is normal for the tenant to receive full entitlement for government payments and subsidies. Tenants will normally pay a cash rental which reflects all expected sources of income from the rented land (crop income plus government payments). Therefore, no sharing of government payments is standard practice.

17. Miscellaneous

The two parties to the lease agreement may write into the lease a clause which would terminate the lease if certain natural disasters occurred. For example, if the land was flooded and the tenant was unable to use the property, it would be unfair to insist that the tenant continue to pay the cash rental unless the level of rent agreed to had taken into account the risk of flooding.

Other unforeseen circumstances include the installation of a highway, gas line, oil well sites, etc. on the rented land thus creating inconvenience and additional operating costs for the tenant. In some instances it may be considered desirable to renegotiate the terms of the lease or compensate the tenant for the added costs or reduced income which he may incur.

X. Other Types of Rental Arrangements

1. Pasture Leases on Privately Owned Land

Pasture lease rates are established by negotiation between landlords and tenants. The rental rate should relate to type of forage, its conditions and carrying capacity.

Budgeting guidelines can be used by a tenant or landlord to establish their position in negotiating pasture rentals. The following are some guidelines:

(i) The Cost Approach

The landlord's costs to own the pasture land are determined. These costs include interest on investment, depreciation, property taxes, insurance and the costs to establish and break the forage crop (for tame forages only).

Example:
--1/2 section seeded pasture: $30,000 value
--Property Taxes $400 (year)
--Fencing: 3.5 miles x $1,400/mile = $4,900 value
--Water Supply: Dugout: $2,500 value
--Breaking, Seeding and Regrassing Costs = $55.00/acre
--Life of Pasture--10 years
--Stocking Rate--350 cow months (70 head for 5 months)

Land Costs: Interest on Investment	
$30,000 x 5% =	$1,500
Property Taxes	400
Fencing Costs: Interest on Average Investment	
$\frac{\$4,900}{2}$ x 12% =	294
Depreciation $4900 x 5% =	245
Repair Allowance $4900 x 2% =	98
Water Costs: Interest on Average Investment	
$\frac{\$2,500}{2}$ x 12%	150
Depreciation $\frac{\$2,500}{}$ x 5% =	125
Breaking, Seeding and Regrassing Costs =	
$\frac{\$55/ac \times 320 ac}{10 years}$	1,760
Total Annual Costs	$4,572

Pasture Cost Summary

Cost Per Cow Month	$\frac{\$4,572}{350} = \$13.06$
Cost Per Cow Per Grazing Season (5 months)	$\frac{\$4,572}{70} = \$65.31$
Cost Per Acre	$\frac{\$4,572}{320} = \$14.29$

(ii) The Contributions Approach

The contributions approach can be used to establish a flexible rent based on the value of calves. The cost contributions of the producer and the landlord who owns the pasture are determined. An equitable share of the value of calves to compensate the landlord for his pasture can then be determined.

The following example illustrates this procedure:

Example:

Pasture Owner's Costs	$/cow
Pasture (see previous example)	$65
Cow Calf Producer's Costs	
Winter Feed	$120
Bedding	9
Veterinary & Medicine	20
Salt, Minerals, Vitamins	20
Breeding Costs	25
Machinery Costs	29
Building & Facilities	24
Death Loss (2%)	15
Cow Replacement $\frac{\$900 - 550}{7 \text{ year}}$	50
Cow Interest $\frac{900 + 550}{2} \times 12\%$	87
Interest on Operating Capital	8
Trucking and Marketing	25
Labour and Management Allowance	75
	$507

Total Contributions = $65 + $507 = $572

Pasture Owner's Share = $\frac{\$65}{572} \times 100\% = 11\%$

Cow Calf Producer's Share = $\frac{\$507}{\$572} \times 100\% = 89\%$

This example shows that approximately 11% of the total cow calf production costs relate to pasture. Therefore, the pasture owner would be entitled to 11% of the value of calves produced each year.

The pasture rent per cow per grazing season could be calculated according to the following formula:

Rent per cow season =

Pasture Owners Percentage Contribution X Average Calf Weight X Average Calf Crop X Average Calf Prices

If the pasture owner's percentage contribution was 11%, the average calf weight was 450 lb, the average calf crop was 90% and the average calf price was $1.20/lb. then the rent/cow season would be calculated as follows:

Rent/cow season =
11% x 450 lb. x 90 % x $1.20/lb. = $53.46

Rather than use the above formula, a simpler approach would be to set the rent per cow season as a percentage of the average price of calves quoted in dollars per hundredweight ($/cwt). Forty-five percent of the price of calves in $/cwt would give approximately the same result as the above formula. The following table shows the rent per cow season for a range of calf prices:

Calf Price ($/cwt)	**Rent/cow Season** (45% of calf prices)
$60.00	$27.00
80.00	36.00
90.00	40.50
100.00	45.00
110.00	49.50
120.00	54.00
130.00	58.50

Rental payments could be based on calf prices in the fall averaged over several weeks or based on a specific date. A partial rental payment could be made in the spring of the year before grazing commences with a final payment in the fall after calf prices are determined.

Pasture rental rates based on calf prices facilitates longer term leases since rental rates adjust automatically with market conditions.

(iii) The Income Approach

With the income approach the tenant would estimate the income from using the pasture, and subtract his costs of production from that amount. This leaves a residual amount that can be paid for pasture.

Example:
Cow Calf Enterprise
Expected Income/Cow

450 lb. calves x 90% calf crop x $1.20/lb	486
Expected Costs for One Year (except pasture)	507
Residual Value for Pasture	$ -21

In this example the income approach leaves a negative residual return to the pasture.

(iv) Pasture Lease Agreement

The following items should be included in a pasture lease agreement in addition to clauses that apply to all leases:

--Date of rental payment.
--Method of calculating the rental payment if a flexible rental arrangement is used.
--Grazing period permitted and other limitations on grazing.
--Number of livestock permitted on the land.
--Rights of the tenant to cut hay.
--Responsibility for fertilization, rejuvenation, rebreaking and seeding.

2. Hay Leases on Privately Owned Land

Farmers often purchase standing hay from landowners. The settlement may be made to the landowner as a rent per acre, a rent per ton or the landlord may receive a share of the hay harvested. The settlement should relate to the quality of the hay, size of fields, yield per acre and condition of the field. Local market conditions are the primary factor which determine values.

The contributions approach, the cost approach and the income approach are procedures that can be used as guidelines to determine shares or a value for standing hay.

The following example illustrates these three approaches:

Landlord's Costs

		$/acre
Interest on Land Investment		
$150/ac x 5%		$7.50
Property Taxes		2.50
Seed, Breaking and Reseeding	$55.00/ac / 6 years	9.17
Total		$19.17

Hay Purchaser's Cost

(Based on 1.0 ton hay/acre)	
Cutting, conditioning, baling and hauling (custom rates less profit margin) $35.00/ton x 1 ton	$35.00
Twine $1.00/ton x 1 ton	1.00
	$36.00
Total Contributions	
$19.17 + 36.00	$55.17
Landlord's Share = $19.17 / $55.17 x 100%	35%
Hay Purchaser's Share = $36.00 / $55.17 x 100%	65%

With the contribution approach a 35:65 ratio is calculated. The hay purchaser could supply 35% of the hay to the landlord or pay cash equal to 35% of the value of the hay. For example, if hay was valued at $60.00 per ton the landlord would receive $21.00/ton (35% x $60.00).

With the cost approach, the landlord would have to charge $19.17 per acre or $19.17 per ton ($19.17/1.0 ton/acre) to cover his fixed and variable costs.

With the income approach, the hay purchaser would subtract his total costs to harvest the hay from the value of the hay leaving a residual value. For example, if hay was valued at $60.00 per ton and the hay purchaser's costs were $36.00 ton, then he could afford to pay $24.00 per ton ($60.00-$36.00) to the landlord for the hay.

The value of silage could be determined using the same methods after adjustments for moisture content.

XI. Custom Farming Arrangements

1. Maintain Farmer Status

Frequently, a landlord wishes to remain classified as a farmer and retain close control of the farming business but not be actively involved in its operation. A custom farming agreement may accomplish this objective.

A farmer, but not a landlord, is able to make contributions to the Canadian Pension Plan on earnings from the farm business.

The custom operator in a custom farming agreement does not have the same rights as a tenant in a land leasing agreement. A custom farming agreement is not an interest in land. Consequently, a caveat can not be placed against the owner's title to protect the custom operator's interest, or to warn third parties of its existence. If the owner sold the land covered by a custom farming agreement to a third party who was unaware of it, the custom operator would have to sue the original owner for contractual damages and would have no right to continue farming the land.

2. Preservation of Capital Gain Rollover Provisions to a Child and Capital Gains Exemption

Land may be rolled over on a tax deferred basis when it is transferred from a parent to a child, providing the child is a resident of Canada and the land is "used in the business of farming" by the parent, his spouse or any of his children immediately prior to the transfer. Land which is leased to anyone other than a spouse, a child, a family farm corporation or family farm partnership would not qualify for a rollover.

To be eligible for the $500,000 capital gains exemption on farmland, the land must be qualified farm property. Qualified farm property is determined by the following factors: type of property, who owns it, who uses it, years of ownership and sources of income.

The specific rules are as follows:

i. The property must be <u>owned</u> by:
   - the individual, (including a personal trust of the individual) or;
   - the individual's spouse, or;
   - a partnership in which the individual or spouse of the individual has an ownership interest.

ii. Property includes:

a) real property (land and buildings) or eligible capital property that has been used in a farming business in Canada by any of the following:

- the individual
- a beneficiary of a personal trust
- a specified family member of the individual which can be a spouse, children, grandchildren, great grandchildren and parents
- a family farm corporation or family farm partnership in which the individual or any specified family members owned a share or interest.

Real property and eligible capital property will not be considered to be used in the business of farming unless the conditions of the following two part test are met.

Part 1: The property must be owned for at least 24 months prior to its disposal by the individual, a specified family member, a personal trust from which the individual acquired the property or by a family farm partnership as defined above, and;

Part 2: (A) During the period the property was owned as indicated in Part 1, for at least a two year period the gross revenue of the farming business must exceed the income from all other sources for the individual, a specified family member, a beneficiary of a personal trust or a personal trust who used the property in a farming business. In addition, the property must be principally used in a farming business and the person who used the property must be actively engaged in the farming business on a regular and continuous basis, OR;

(B) for at least 24 months while the property was so owned, it was used by a family farm corporation or family farm partnership of an individual or a specified family member, in carrying on the business of farming in Canada during which time an individual or a specified family member was actively engaged on a regular and continuous basis in the farming business in which the property was used.

In those situations where an individual fails to meet this two part ownership and income test then if it is advantageous to the taxpayer, the following rules may be used if the property was acquired prior to June 18, 1987:

The property was used principally in the course of carrying on a farming business in Canada by an individual, a specified family member, or a family farm corporation or family farm partnership in which the individual or a specified family member owned a share or partnership interest,
(A) in the year the property was disposed of by the individual, or,
(B) in at least five years during the period of ownership by the individual, a specified family member, a personal trust from which the individual acquired the property, or a family farm partnership in which the individual or a specified family member has an interest.

c) an interest owned by the individual or the spouse of the individual in a family farm partnership,
d) shares owned by the individual or the spouse of the individual in a family farm corporation.

Farm property other than "qualified farm property" is eligible for the basic $100,000 capital gains exemption.

For a rollover of capital gain to occur on a property exchange, the land must be "used in the business of farming" by the owner. Land leased to anyone would prevent a property exchange rollover from occurring.

In a properly structured custom farming agreement, the land will be considered to be "used in the business of farming" as opposed to being a rental property as in a lease agreement. A farm owner may engage the services of another person to undertake virtually all of the work associated with his farming activities (custom working). However, the owner of the farm property should assume some risk and provide the management for the operation.

To be at risk, the farm owner should pay some of the operating costs and stand to lose money if there was a crop failure. His management should take the form of decision making responsibilities for such functions as determining crops and varieties to be grown, fields to be seeded and fallowed, timing of field operations, inputs to be used and dates of crop sales.

In using custom farming agreements, it is important that the actual relationship that exists between the landowner and the custom operator conforms to the agreement. **Revenue Canada will look at the actual facts of the situation, not the agreement, if there are discrepancies between an agreement and the facts of the situation.**

Landowners should consider documenting their decision making responsibilities by way of copies of letters of instruction or minutes of meetings.

3. Types of Custom Farming Agreements

There are many variations to custom farming agreements. However, three general categories of arrangements exist. These are:

(i) Custom Hiring Agreement

The landowner (farmer) makes all the farming decisions, arranges for and pays for the purchase of all inputs and receives all the income from grain sales. The landowner and the custom operator agree to have the custom operator perform some or all machine operations. The landowner agrees to pay a custom fee to the custom operator upon the completion of each machine operation.

A variation of the above is for the landowner to pay the custom operator a basic lump sum fee by a certain date say, July 31, of each year plus a bonus after the final accounting is completed for the year. The bonus could be a percentage, say 40% of "net income". "Net income" would be the value of all crop sales attributed to the year minus the costs of custom work, seed, fertilizer, chemicals and property taxes. The bonus percentage amount should depend on the size of the basic lump sum fee in relation to actual custom rates in the area.

(ii) Joint Farming Venture Agreement

In this agreement, both parties are considered to be farmers. The landowner supplies land to the joint venture and the other party supplies machinery, machinery operating costs and labour.

The two parties then share the crop sales on a percentage basis, say 35:65, and also share the input costs (seed, fertilizer, chemicals, crop and revenue insurance) on the same basis. Both parties benefit from crop insurance coverage and revenue insurance indemnities.

(iii) Farming Partnership Agreement

The agreement is much the same as in the joint venture, except that a partnership is established with more defined rules to govern the relationship.

Some custom farm agreements have been drafted in a manner that gives the same financial results as a crop share lease. A common agreement is one where the landowner (the "farmer") takes out the Canadian Wheat Board permit book in his name. All the crop is sold in the "farmer's" name. After each grain sale or CWB payment is received, the "farmer" pays cash equal to, say, two thirds of the income received to the custom operator. The custom operator supplies seed, fertilizer, chemicals, machinery, labour and machinery operating costs. It is quite evident that it is the same as a crop share lease. Revenue Canada is very likely to look at these agreements as leases. Therefore, the landowner would not qualify for a capital gain rollover to his child or a rollover on a property exchange.

Consult a lawyer, accountant or farm management agrologist before entering into any custom farming agreement since some agreements may not meet the "used in the business of farming" criteria. Review custom farming agreements that were entered into several years ago to determine if they are in tune with current requirements.

XII. Land Leases and the Income Tax Act

The following information outlines the major provisions of the Income Tax Act as related to leasing of farmland. It should not be considered as either interpretation or complete coverage of the Act. Specific problems should be discussed with your farm management agrologist, accountant, tax consultant, or lawyer. Revenue Canada will also provide information.

1. Income and Expenses

The "Farmer's Income Tax Guide" indicates the income and expenses which may be claimed by the farmer (tenant) and landlord. For example, cash rental payments are income to the landlord and a deductible expense for the tenant. Crop-share payments are income to the landlord. They are not a deductible expense for the tenant unless he reports the total gross income from the rented property. The tenant may claim the cost of repairs as a deduction and capital cost allowance on improvements which he makes to the landlord's property. Landlords can claim capital cost allowance on depreciable property included in the lease.

2. Non-Resident Withholding Tax

If the landlord is a non-resident of Canada and resides in the U.S.A., the tenant must withhold 15% of the rent (cash rental or crop-share) and send it to Revenue Canada. A common practice with crop-share lease agreements is to have a separate bank account in the name of the landlord. The tenant deposits the landlord's share of crop in the account with the provision that the bank will remit 15% to Revenue Canada. When the tenant does not remit the 15% withholding tax, Revenue Canada will attempt to collect the tax from the landlord. If the landlord does not pay this tax.. the tenant will be held responsible.

The withholding tax rate will vary for non-residents residing in countries other than the U.S.A. Check with an accountant or Revenue Canada for specific rates in other countries.

The individual who remits the withholding tax must complete and forward an NR4 return to Revenue Canada at the end of the year.

3. Capital Cost Allowance

When a landlord rents his farm or machinery, the Income Tax Act requires that he switch from the Straight Line Method (Part XVII) of capital cost allowance to the Declining Balance Method (Part XI). In most cases this is undesirable since it would mean that all recaptured capital cost allowance that occurs when the class is closed out (e.g., sale of all machinery in that class) would be taxable income. This problem could be avoided by the tenant hiring the machinery on a custom basis with the fee being a share of the crop or cash payment. For this situation, switching to Part XI method of capital cost allowance is not required.

Where the tenant makes improvements to the rented property at his own expense he is entitled to claim capital cost allowance on depreciable items. These improvements might include major alterations to existing structures or the construction of dugouts, dams, fences and corrals, permanent grain storage and livestock buildings.

If the tenant receives compensation from the landlord or sells the asset, recaptured capital cost allowance and capital gain might occur. Since permanent improvements belong to the land, they are legally owned by the landlord. For this reason it is important the tenant receive fair compensation whether it be in the form of reduced rent or cash payment.

4. Five Year Block Average

The landlord in a crop share arrangement may be eligible to do a five year block average for all his income if the net income from farming for those five years exceeds his non-farm income. Rental income from a crop share lease is defined as farming income. It is recommended the landlord consult with an accountant when investment income might influence whether he is eligible for a five year block average.

The five year block provision is not available to the landlord in a cash rental arrangement.

Five year block averaging is being phased out. The last block average must include the taxation year 1987.

5. Canada Pension Plan and Registered Retirement Savings Plan

Rental income can not be used as a basis for contributions to the Canada Pension Plan. Farmers who lease their land prior to age 60 and have no employment or self-employment income will be unable to make contributions to the plan. This will have the effect of reducing their Canada Pension Plan pension at age 60.

Although rental income is not eligible for contributions to the Canada Pension Plan, it is eligible for contributions to a Registered Retirement Savings Plan.

Rather than lease his land a landowner may consider hiring the farm work on a custom basis or enter into a joint venture or partnership. The net income from these sources are eligible for contributions to the Canada Pension Plan.

6. Capital Gains Rollover

An individual may transfer farmland to any of his children either during his lifetime or after his death on a capital gain rollover, providing that the land was used in the business of farming by himself, his spouse or any of his children. Children include sons-in-law, daughters-in-law, grandchildren and great grandchildren.

If the land is leased to someone other than a spouse, a child or to a corporation or partnership operated by himself, his spouse or a child, a capital gain rollover to a child is not possible. For this reason, many landowners hire the farm work on a custom basis rather than leasing. This preserves the capital gain rollover (see the section on Custom Farming Arrangements).

7. Capital Gains Tax Exemption

"Qualified farm property" is eligible for a capital gains exemption of $500,000. (See the section on Custom Farming Arrangements.)

8. Goods and Service Tax (GST)

Rent which is paid by way of share of the crop is not subject to the goods and service tax.

The treatment of cash rents for GST purposes depend on whether the landlord is registered with Revenue Canada, to collect and remit the GST. Generally, a business (including a landlord who rents property) will not have to register if their taxable and zero-rated sales are under $30,000. A landlord whose only source of business income is rent and the amount is less than $30,000 need not register. If a landlord is not a GST registrant, then the landlord is not required to charge the tax on the rent. The landlord is unable to recover GST paid on taxable goods and services but may claim the full amount (including GST) as allowed for business expense deductions for income tax purposes. However, if the landlord is registered, then the GST must be charged on cash rentals. The landlord must remit the GST collected when his GST return is filed. The tenant is able to claim an Input Tax Credit on the tax paid.

XIII. Land Leases and the Law

The following is an outline of the law pertaining to land leases. It should not be considered as an interpretation or complete coverage of the existing statutes and court case decisions. It is recommended that you consult with a lawyer where specific problems arise.

A land lease is a contract by which one person, called the landlord or lessor, conveys the use of real (land) property to another person, called the tenant or lessee, for a period of time, called the term, for a consideration called rent.

A lease agreement is like all other contracts in that both parties must be competent to contract. A lease by or to a minor or mentally incompetent person may not be binding or, the parties and a lawyer should be consulted prior to entering into such a lease.

A lease arrangement may be verbal or written and can be for any specified period of time.

The following is a general note with respect to land leases:

1. Verbal Lease

A verbal lease for a term not exceeding three years is valid and enforceable if:
(i) the tenant takes possession of the property
(ii) the property is not a homestead under the "Homesteads Act".
It does not have to be registered at the Land Titles Office. If another person should purchase the land from the landlord, the new landlord must honour the existing lease providing the tenant is in actual occupation of the land. The onus is therefore on the purchaser to ensure the property has not been rented out either under a verbal or written agreement. The purchaser should make enquiries in the district to determine who farmed the land last year.

If the land comprises the landlord's homestead a verbal contract is not binding since the landlord's non-owning spouse must give written consent to the agreement. For this reason it is recommended that a written lease be completed for a homestead quarter.

2. Written Lease

A lease for a term exceeding three years to be enforceable is required by the Statute of Frauds to be in writing. When a lease is written, it should state all the terms and conditions because any verbal promises given in addition to the written agreement may not be binding.

Although a written lease exceeding three years is binding on the existing landlord and tenant it should be registered with the Land Titles Office to ensure that it shall be valid and enforceable if the property is sold to a new owner.

3. The Land Titles Act and The Landlord and Tenant Act (Provincial)

These two Acts outline among other things, all the implied obligations by the landlord and tenant unless they have been specifically excluded in a written agreement. These include the following:
(i) The tenant will pay the rent agreed to in the lease.

(ii) The tenant can peaceably possess and enjoy the property for the term of lease without interference from the landlord.

(iii) The tenant is obligated to make repairs and to maintain the property in the same condition in which he took it except for reasonable wear and tear, and damages arising from natural hazards.

(iv) The landlord or his agent can enter upon the leased land to inspect the rented property. He may also request in writing that the tenant make specified repairs within a reasonable time period.

(v) Where the tenant is in default of payment or any other condition of the agreement for a period of two months, the landlord may repossess and occupy the rented property.

4. The Homesteads Act 1989 (Provincial)

This Act requires that the landlord's non-owning spouse give written consent (Consent of Non-Owning Spouse) to every lease agreement involving the homestead parcel. A "Homestead" is any land(s) upon which the spouses have lived since their marriage in which the owning spouse has an equity interest. A person may have several homesteads. The Act also requires that the non-owning spouse appear before a solicitor, notary public, justice of the peace, registrant of land titles, local registrar of the Court of Queen's Bench, or district court judge to have "The Certificate of Acknowledgement" completed. This is to ensure that the non-owning spouse understands his/her rights in the homestead and that he/she signs the lease agreement and "Consent of Non-Owning Spouse" of his/her own free will and consent and without any compulsion on the part of the owning spouse. The "Affidavit of the Landlord" should be completed if the landlord has no spouse, or if the land in the Agreement has never been part of a homestead, or if the landlord's spouse's Homestead Rights were relinquished by an interspousal agreement or Court Order pursuant to The Matrimonial Property Act.

5. Registration of a Lease

In order to ensure that a lease is valid and enforceable against a purchaser, a lease exceeding three years must be either recorded on the certificate of title as a "lease registration" or recorded by means of a "caveat".

The Land Titles Act of Saskatchewan requires that when land, for which a certificate of title has been granted, is rented out for a term exceeding three years the lease agreement must be in a certain format (Form M) before it can be registered.

Sample lease agreement forms available from Saskatchewan Agriculture and Food meet the required format.

The Land Titles Act does not make any provision for the registration of a lease which has a term of three years or less. In addition, "Lease Registration" is not permitted in situations where the land is controlled by the landlord under an agreement for sale or the written agreement does not conform to the required format. In these situations, the tenant's interest can be protected by filing a caveat on the certificate of title.

A fee is charged by the Land Titles Office for a lease registration. Land Titles Offices are located in Battleford, Humboldt, Moose Jaw, Prince Albert, Regina, Saskatoon, Swift Current, and Yorkton. The Land Registration Districts of Saskatchewan are outlined in Appendix 2.

6. Removal of a Lease Registration

After a registered lease has expired, the landlord naturally wishes that it be cancelled from his title. This can be done by having the tenant complete a "Surrender of Lease" form and by registering it in the appropriate Land Titles Office. Fees charged are the same as for lease registrations.

Leases which are registered by way of "caveat" on a certificate may be removed by the method outlined in the section "Removal of a Caveat".

When a lease that was registered expires, the landlord may request the Registrar of Land Titles to remove the lease registration. This is done by the Registrar serving a notice lapse to the tenant. If the tenant does not file a notice with the Registrar within thirty days that he still has an interest in the land, the lease registration will lapse.

7. Caveat

The word caveat means "to be aware". Caveats are registered by parties who have or claim they acquired some interest in land under a document that cannot be registered. This would include a leasehold interest in buildings. Any dispute which may arise with respect to such claims may have to be resolved by the Court.

The caveat can be recorded in the certificate of title by sending the caveat in the form prescribed to the Land Titles Office together with the required form.

Any person finding a caveat recorded on the title should be on his guard before purchasing the property. He should find out what the caveat is all about before completing the purchase.

8. Removal of a Caveat

The caveat can be removed by the tenant completing the "Withdrawal and Discharge of Caveat" form prescribed by The Land Titles Act and sending it to the appropriate Land Titles Office. Fees charged are the same as for recording a caveat. It can also be removed by the landlord submitting a request to the Registrar of lands Titles. The registrar will serve notice to lapse upon the tenant (caveator). If within 30 days thereafter, the tenant does not register an order of the Court extending this 30 day period, the caveat will lapse at the expiration of this time.

9. Permanent Improvements

Permanent Improvements such as buildings, fences, wells, dugouts, clearing and breaking, which are made by the tenant become part of the land and therefore are legally owned by the landlord unless there is an agreement to the contrary. Prior to making permanent improvements the tenant should have written permission from the landlord. It should clearly outline what buildings or improvements are to be made, who will pay the cost of materials and how the tenant will be compensated at the termination of the lease for his labour or any costs which he may incur. The tenant could be compensated in the following ways:

i) reduced rental,
ii) cash payment based on the market value of the improvement at the termination of the lease,
iii) longer term lease with no increase in the rental.

In situations where a son erects a building (e.g., hog barn) on his father's land the same legal implications apply. To protect his interest in the building the son should complete a leasehold agreement with the father and file a caveat against his father's title. This would warn potential purchasers that a tenant has an interest in the property which must be honoured.

10. Canadian Wheat Board Act (Federal)

The Canadian Wheat Board's policy is to issue a special permit book for quota purposes to those grain producers (actual producers and landlords) who have ceased farming operations entirely but do not have access to a current crop year permit book. This also applies to grain producers who have reduced their quota acreage by the sale of land or expiry of a lease agreement.

When a lease agreement expires and the tenant ceases to farm the rented property he is eligible to apply for a special permit book to deliver his share of grain carry-over produced on the property. If the landlord merely changed tenants he does not qualify for a special permit book. He would have to either deliver his share of grain carry-over through the permit book of his new tenant or seel the grain as non quota grains (e.g., feedlot).

11. Gross Revenue Insurance Plan and Net Income Stabilization Account

GRIP

Only actual producers are eligible to hold a GRIP contract. Landlords are not able to participate directly. Landlords and tenants that enter into a lease can negotiate and agree with respect to sharing premium costs and program benefits.

Other agreements such as custom hiring agreements, joint farming venture agreements and partnership agreements give consideration to landowners as farmers (producers) by Revenue Canada, the Canadian Wheat Board (re: permit books) and Crop Insurance (crop insurance and/or revenue insurance).

Planning is required to incorporate GRIP into a lease agreement which accommodates the needs of both landlords and tenants.

NISA

Landlords may make contributions to their own NISA on income received in the form of crop-share rental income. However, landlords may not make contributions on income from cash rental leases. A landlord can make contributions to NISA on income from flexible cash lease agreements where the tenant provides the landlord with a fixed quantity of production which is sold in the landlord's name.

12. The Agriculture Leasehold Act

Situations can arise whereby the tenant is unable to harvest the crop or remove stored grain from the rented land before termination of the lease. This includes bad weather conditions, lack of grain storage facilities and conditions which prevent the sale of grain (e.g., quotas).

The Agricultural Lease Act outlines the conditions under which a tenant may re-enter upon the land to harvest a crop and remove the stored grain. Where harvesting was completed before termination of the lease but grains remained stored on the rented property of the tenant must give written notice to the owner or occupant of the land at least seven days prior to re-entering but not later than June 1 following termination of the lease. The written notice must specify the nature and extent of the work to be carried out and the approximate date of re-entry which must not be later than June 15. Removal of the stored grain must be completed by June 30.

Where re-entry is made by the tenant to complete the harvest, written notice at least seven days prior to re-entry but not later than April 1 after termination of lease must be given to the occupant or where the land is unoccupied to the owner. The notice must also specify the nature and extent of work to be carried out and the approximate date of re-entry which must not be later than May 1 following the date of termination of the lease and the tenant shall complete the harvesting and withdraw from the land not later than May 15.

The conditions as specified in the Agricultural Leasehold Act, apply to any agricultural land lease.

13. Termination of Leases

The following are situations in which a lease may be terminated:

i. A lease termination automatically at the end of the term. When the term of a lease expires but the tenant continues possession of the property, the landlord can take action under the Landlord Tenant Act to have the tenant removed.

ii. A tenant may surrender a lease. Procedures for surrendering a lease are provided for in the Land Titles Act.

iii. When the landlord sells the property under lease to the tenant, the lease is terminated. If the tenant had registered the lease by means of a lease registration or caveat, then the lease registration or caveat must be discharged by the tenant in the usual way even though the tenant purchases the property.

iv. A lease is terminated when a party holding a mortgage (mortgagee) on the land, granted prior to the lease, forecloses and the mortgagee had not originally consented to the renting of the property to the tenant.

v. Termination can occur by the landlord issuing a Notice to Quit to the tenant. A Notice to Quit is used when a lease does not expressly state a termination date or is a verbal lease. Unless the lease provides otherwise, six months notice prior to the calendar date of commencement of a lease for a year or more is required for termination. For a verbal lease, the date of commencement may be difficult to prove. The date of original possession of the land by the tenant would be an indication of this date.

vi. A landlord could take action under the provisions of the Landlord-Tenant Act to repossess the property for breach of contract by the tenant. Breach of contract most normally occurs if rent is not paid or the tenant is overholding. Breach of contract for poor farming practices or other reasons are more difficult to prove unless the lease agreement clearly states the responsibilities of the tenant.

vii. When land is sold to a third party by the landlord who entered into a lease with a tenant enforced by the tenant against the new landlord unless he had registered the lease or caveat at the Land Titles Office. In such cases the lease would be terminated. However, a lease three years or less in length can be enforced by the tenant in actual occupation of the land.

Appendix I

1. Contributions Approach

Landlord's Cost Per Cultivated Acre

Land

Investment Cost

$_____ per acre x _____% _____

Taxes _____

Buildings

Investment Cost

$_____ per acre x _____% _____

Depreciation _____

Repairs _____

Other Costs _____

A. Landlord's Total Costs Per Cultivated Acre _____

Tenant's Cost Per Cultivated Acre

Seed and Seed Related Cost _____

Fertilizer
- Summerfallow _____
- Stubble _____

Chemical
- Broadleaf weeds _____
- Grassy weeds _____
- Other _____

Crop Insurances _____

Machinery
- Investment Cost _____
- Depreciation _____
- Repairs _____
- Fuel and Lubricants _____

Miscellaneous _____

Labour _____

Interest _____

B. Tenant's Total Costs Per Cultivated Acre _____

Total Cost contributed = A + B = _____

$$\text{Landlord's Share} = \frac{A}{A + B} \times 100 = _____\%$$

$$\text{Tenant's Share} = \frac{B}{A + B} \times 100 = _____\%$$

Note:

(a) Do not include costs which are to be shared in the same proportion as the share of crop, (e.g., fertilizer, wild oat spray).

(b) If land taxes or repairs on the landlord's buildings are paid by the tenant, these should be included with the tenant's costs. Similarly, if the landlord supplies machinery, the investment and depreciation costs should be added to the landlord's costs.

2. Income Approach Worksheet (for use by a tenant or landlord)

Expected Income

Crop	Acres	x	Yield	x	Price	=	Income	My Share
		x		x		=		
		x		x		=		
		x		x		=		
		x		x		=		
		x		x		=		
		x		x		=		

Other Income

Total Expected Income **(A)**

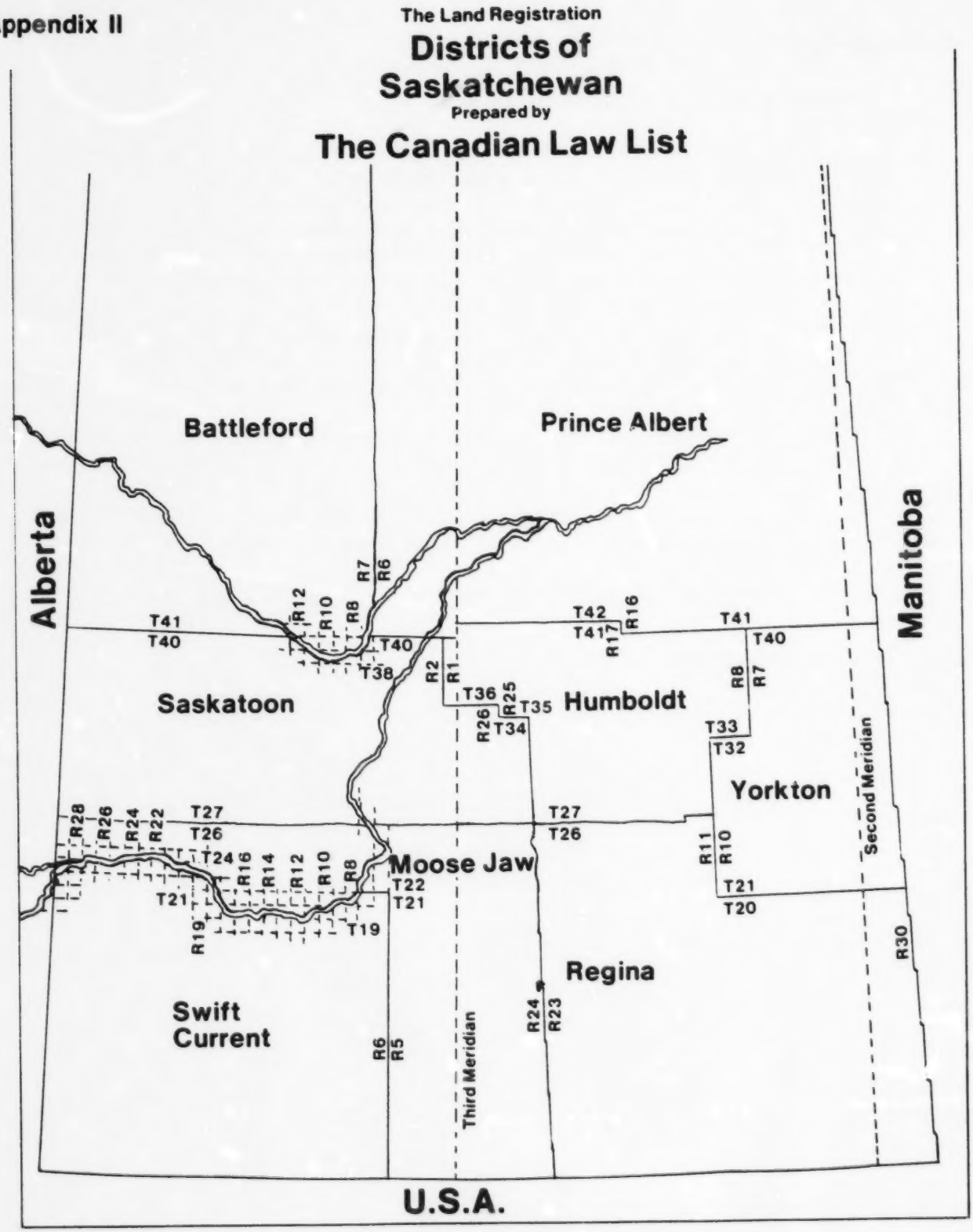
Estimated Extra Costs

Cost:	**Total**	**My Share**
Seed		
Fertilizer		
Chemicals		
Building Repairs		
Machinery - fuel, lube		
- repairs and maintenance		
Crop and Hail Insurance		
Property Taxes		
Custom Work Hired		
Hired Labour		
Rent (if a cash rent)		
Interest on Operating Capital		
Extra Machinery Depreciation = $\frac{\text{orig. cost - salvage value}}{\text{years of use}}$ = ____ - ____		
Extra Machinery Investment Cost = $\frac{\text{orig. cost + salvage value}}{2}$ x int. rate = $\frac{\quad + \quad}{2}$ x ____%		
Extra Machinery Insurance		
Other Costs:		

Total Extra Costs **(B)**

Return Above Extra Costs (A-B)

Appendix II


The Land Registration
Districts of
Saskatchewan
Prepared by
The Canadian Law List
Battleford
Prince Albert
Alberta
Manitoba
Saskatoon
Humboldt
Yorkton
Moose Jaw
Regina
Swift
Current
Second Meridian
Third Meridian
U.S.A.

Appendix III

Cropping Decisions for Crop Share Leases

Tenants with crop share leases must often make different cropping decisions than on land owner or leased on a cash rental basis.

The most profitable level of fertilizer use, chemical application, types of crops grown and the length of crop rotation are key cropping decisions that may be different for land leased on a crop share basis. By properly structuring a crop share lease, whereby the landlord pays a proportionate share of yield increasing inputs like fertilizer and chemicals or by adjusting the crop share percentages for longer rotations, it may be possible to adopt the same profit maximizing decisions for land leased on a crop share basis as for owned land or land leased on a cash basis.

This analysis illustrates a budgeting approach that can be used to indicate fair divisions of a crop between a tenant and landlord for four different crop rotations. Procedures to calculate the impact of alternative crop rotations on tenant's and landlord's net income is also shown. Modifications to crop share leases are discussed in order to maintain a fair leasing arrangement.

Fair Crop Shares for Alternative Crop Rotation Lengths

The contributions approach was used to calculate crop share ratios for tenants and landlords. The contributions approach suggests that a tenant and landlord should share in the crop in the same proportion as they contribute to the costs of growing the crop.

Four rotations compared were 1/2 crop, 2/3 crop, 3/4 crop and continuous crop. Costs and returns were based on renting one-quarter section with 160 cultivated acres and a total farm size of 1,000 cultivated acres. The percentage crop share for the four rotations and two alternative methods of sharing input cost is summarized in Table 1. Detailed calculations are illustrated Tables 2 and 3.

Table 1
Fair Crop Shares for Various Rotations and Types of Leases

Types of Crop Share Lease	Crop Rotation 1/2 Crop	2/3 Crop	3/4 Crop	Continuous Crop
1. Landlord pays taxes & granary repairs:				
Tenant's share	75%	78%	79%	82%
Landlord's share	25%	22%	21%	18%
2. Landlord pays taxes & granary repairs and shares chemicals & fertilizer in same proportion as crop:				
- Tenant's share	73%	75%	75%	77%
- Landlord's share	27%	25%	25%	23%

Table 1 indicates that the tenant must receive a larger percentage share of the total crop as rotations of greater length are used in order to maintain a fair agreement. While the landlord may receive a smaller crop share, it does not mean that his net income declines since the landlord will have a smaller share of a larger crop.

In leases where the landlord shares the fertilizer and chemical costs with the tenant in the same proportion as the crop share, he is entitled to a larger crop share than in those cases where no input sharing occurs.

Table 2
Crop Share Rental Calculations Where Landlord Pays Property Taxes and Granary Repairs

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Tenant's Costs				
Machinery Operating	2,000	2,293	2,440	2,880
Seed	400	533	600	800
Fertilizer-Phosphorus	400	533	600	800
-Nitrogen		640	960	1,920
Fertilizer bander rental		160	240	480
Chemicals				
-Wild oat	320	427	480	640
-Broadleaf	240	320	360	480
Crop Insurance	240	267	280	320
Interest on tenant's cash operating expenses	180	260	300	420
Labour and Management	2,400	2,500	2,600	2,800
Machinery Investment	1,920	2,200	2,340	2,760
Machinery Depreciation	2,240	2,570	2,730	3,230
Total Tenant's Costs (A)	10,340	2,703	13,930	17,530
Landlord's Costs				
Property Taxes	640	640	640	640
Granary repairs and Insurance	60	75	80	110
Interest on Landlord's Cash - operating Expenses	35	35	35	40
Granary Depreciation	140	190	210	280
Granary Investment	280	370	420	560
Land Investment	2,240	2,240	2,240	2,240
Total Landlord's Cost (B)	3,395	3,550	3,625	3,870
Total Tenant and Landlord Costs (A & B)	13,735	16,253	1,756	521,400
Tenant's Crop Share	10,340 / 13,735 = 75%	12,703 / 16,253 = 78%	13,930 / 17,555 = 79%	17,530 / 21,400 = 82%
Landlord's Crop Share	3,395 / 13,735 = 25%	3,550 / 16,253 = 22%	3,625 / 17,555 = 21%	3,870 / 21,400 = 18%

Table 3
Crop Share Rental Calculations Where Landlord
- Pays Property Taxes and Granary Repairs
- Shares Fertilizer and Chemicals Cost in Same Proportion as the Crop

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Tenant's Costs				
Machinery Operating	2,000	2,293	2,440	2,880
Seed	400	533	600	800
Fertilizer and Chemicals	700	1,560	1,980	3,325
Crop Insurance	240	267	280	320
Interest on tenant's cash operating expenses	170	235	265	370
Labour and Management	2,400	2,500	2,600	2,800
Machinery Investment	1,920	2,200	2,340	2,760
Machinery Depreciation	2,240	2,570	2,730	3,230
Total Tenant's Costs (A)	10,070	12,158	13,235	16,485

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Landlord's Costs				
Fertilizer and Chemicals	260	520	660	995
Property Taxes	640	640	640	640
Granary Repairs and Insurance	60	75	80	110
Interest on Landlord's Cash Operating Expenses	45	60	70	90
Granary Investment	140	190	210	280
Granary Depreciation	280	370	420	560
Land Investment	2,240	2,240	2,240	2,240
Total Landlord's Cost (B)	3,665	4,095	4,320	4,915
Total Tenant and Landlord Costs (A & B)	13,735	16,253	17,555	21,400
Tenant's Crop Share	10,070 / 13,735 = 73%	12,158 / 16,253 = 75%	13,235 / 17,555 = 75%	16,485 / 21,400 = 77%
Landlord's Crop Share	3,665 / 13,735 = 27%	4,095 / 16,253 = 25%	4,320 / 17,555 = 25%	4,915 / 21,400 = 23%

Effects of Rotation Length on Tenant and Landlord Return Above Cash Costs

Unless a crop share lease is properly structured there may be no incentive for the tenant to extend the length of crop rotations. Table 4, Example 1 indicates that the tenant's return above cash costs declines for longer rotations when he receives a two-thirds crop share for all rotations and pays all the input costs.

Table 4, Example 2, indicates the tenant's return above cash costs when the crop share ratio is adjusted for longer rotations, At a wheat price of $3.50 per bushel there is a small incentive for the tenant to extend the rotation beyond the 112 crop rotation.

Table 4, Example 3, indicates the tenant's return above cash costs where the crop share ratio is adjusted for longer rotations and the landlord pays a proportionate share of the fertilizer and chemical costs. As with Example 2, the tenant's return above cash cost increases only slightly with the longer rotations.

The effect of rotation lengths on the landlord's return above cash costs is shown in Table 4, Examples 1, 2 and 3. In Example 1, the landlord's return above cash costs increases significantly with longer crop rotations. Where the landlord's crop share is based on the contributions approach as illustrated in Table 4, Examples 2 and 3, the level of the landlord's return above cash costs does not change appreciably with longer crop rotations.

Table 4
Effect of Crop Rotation on Tenant's and Landlord's Income

Assume
- landlord pays taxes and granary repairs
- summerfallow wheat crop 35 bushels/acre
- stubble wheat crop 28 bushels/acre
- wheat at $3.50/bushel

Example #1 - Tenant receives 2/3 crop share in all rotations

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Wheat Produced (bu)	2,800 bu	3,358 bu	3,640 bu	4,480 bu
Value of Production	$9,800	$11,753	$12,740	$15,680
Tenant's Share	6,534	7,835	8,493	10,453
Less Tenant's Cash Costs	3,780	5,433	6,260	8,740
Tenant's Return Above Cash Costs	2,754	2,402	2,233	1,713
Landlord's Share	3,266	3,918	4,247	5,227
Less Landlord's Cash Costs	735	750	755	790
Landlord's Return Above Cash Costs	2,531	3,168	3,492	4,437

Example #2 - Tenant receives a crop share based on the contributions approach.
- Landlord receives a crop share based on the contributions approach.

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Value of Production	$9,800	$11,753	$12,740	$15,680
Tenant's Crop Share	75%	78%	79%	82%
Tenant's Share	7,350	9,167	10,065	12,858
Less Tenant's Cash Costs	3,780	5,433	6,260	8,740
Tenant's Return Above Cash Costs	3,570	3,734	3,805	4,118
Landlord's Crop Share	25%	22%	21%	18%
Landlord's Share	2,450	2,586	2,675	2,822
Less Landlord's Cash Costs	735	750	755	790
Landlord's Return Above Cash Costs	1,715	1,836	1,920	2,032

Example #3 - Tenant receives a crop share based on the contributions approach. In addition to taxes and granary repairs, the landlord shares fertilizer and chemical costs in the same proportion as the crop.

	Crop Rotation			
	1/2-1/2	1/3-2/3	1/4-3/4	Continuous
Value of Production	$9,800	$11,753	$12,740	$15,680
Tenant's Crop Share	73%	75%	75%	77%
Tenant's Share	7,154	8,815	905555	12,074
Less Tenant's Cash Costs	3,510	4,888	5,565	7,695
Tenant's Return Above Cash Costs	3,644	3,927	3,990	4,379
Landlord's Crop Share	27%	25%	25%	23%
Landlord's Share	2,646	2,938	3,185	3,606
Less Landlord's Cash Costs	1,005	1,295	1,450	1,835
Landlord's Return Above Cash Costs	1,641	1,643	1,735	1,771

Conclusion

When leasing land on a crop share basis it is important to consider the rotation to be used as well as the contributions by both the landlord and tenant. A change in the crop rotation may not be economically sound unless the lease agreement is adjusted.